

## Unlock Your Value

### Attracting Capital and Why it Matters in Assisted Living and Personal Care

Presented To:

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By:

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## Current Events / Fall 2019

### Senior Living Operations

- Higher Fixed Costs “pinch” operations
- All time high prices: labor (\$15 minimum wage), food, and insurance premiums
- Labor Shortage: find and retain compassionate care givers
- Demographics: tidal wave of seniors demanding affordable housing and care

### The Finance Environment

- Banking: burdened by industry wide regulation, Dodd Frank law in 2010
  - HVCRE - Limits Lenders from making certain types of loans that are “high risk”
    - (1) Construction
    - (2) High debt %
- Interest rates at historic lows
- 10-year U.S. Treasury rates dipped below 1.5% in 2019
- Cap rates for Senior Living Facilities.
  - ALF = 8% cap
  - SNF = 12% cap

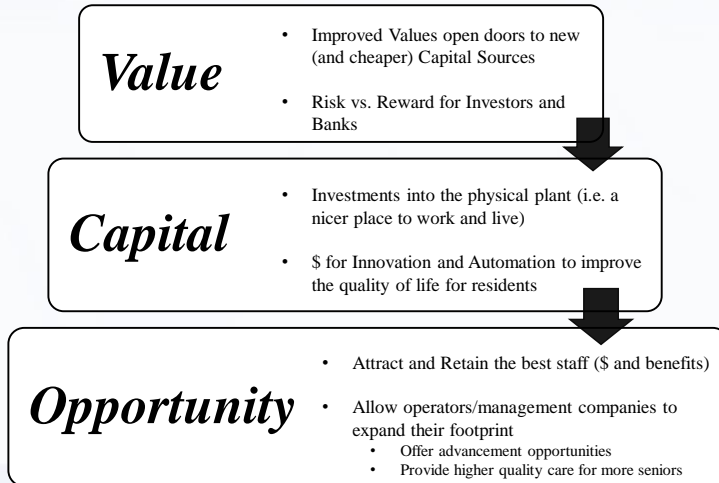
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## Improve Value, Attract Capital, and Create Opportunity in Seniors Housing



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## Strong Financial Management Helps Seniors' Housing Communities Achieve Their Goals

- I. Introduction to a Financial Report Card
- II. How Valuable is Your Community?
- III. How A+ Management Creates Value
- IV. Factors that Affect Value (+/-)
- V. Conclusions and Q&A

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## I. Introduction to a Financial Report Card

- **Financial Report Card** is a financial representation of some, or all, aspects of a business. The Report Card is similar to an Income Statement and makes recommendations based on that information. It may also compute certain key ratios such as:
  - Revenue per Licensed Bed
  - Operating Expenses per Resident Day.
  - Operating Income Margin
- Purposes:
  - 1) Use data from the past and present to attempt to predict future performance
  - 2) Using current data to value a Community– much like appraisals

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## Building a Financial Report Card Starts with the Income Statement

	Year					
	2015	2016	2017	2018	2019	
<i>Revenue Growth</i>		3.0%	3.0%	3.0%	3.0%	
<b>Base Rental Revenue</b>	2,345,678	2,416,048	2,488,530	2,563,186	2,640,081	
<i>Other Revenue</i>	33,108	35,000	35,000	35,000	35,000	
<b>Effective Gross Revenue</b>	\$ -	<b>2,378,786</b>	<b>2,451,048</b>	<b>2,523,530</b>	<b>2,598,186</b>	<b>2,675,081</b>
<b>Operating Expenses</b>						
Real Estate Taxes	61,000	62,830	64,715	66,656	68,656	
Management Fees	118,939	122,507	126,183	129,968	133,867	
Insurance	34,000	42,586	43,864	45,179	46,535	
General and Admin	510,800	526,124	541,907	558,165	574,910	
Resident Services	539,616	555,804	572,479	589,653	607,343	
Plant Ops, Utilities, and Maintenance	224,850	231,596	178,905	184,272	189,800	
Dining	247,038	254,449	262,083	234,334	241,364	
Other	65,723	67,695	69,726	71,818	73,972	
<b>Total Operating Expenses</b>	<b>1,801,966</b>	<b>1,863,591</b>	<b>1,859,861</b>	<b>1,880,046</b>	<b>1,936,447</b>	
<b>Net Operating Income</b>	<b>576,819</b>	<b>587,457</b>	<b>663,669</b>	<b>718,140</b>	<b>738,634</b>	
<b>NOI Margin</b>	24.2%	24.0%	26.3%	27.6%	27.6%	

- 3 Key Line Items: Gross Revenues, Total Operating Expenses, and Net Operating Income (NOI)
- NOI will be the primary driver of the overall valuation

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## Net Operating Income Drives Value In Senior Housing

- **Net Operating Income:** income from core operations before financing costs and non-cash items.
- AKA: “NOI” “Cash Flow” “EBITDA”
- Why Important?
  - Determine borrowing capacity (ability to cover debt service payments)
  - Banks, appraisers, investors use this figure more than any other to value a community
  - Quick Valuation:  $\text{NOI} / \text{Capitalization Rate} = \text{Market Value}$

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## Compiling a Financial Report Card Helps Measure Performance

		Year				
		2015	2016	2017	2018	2019
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<b>Total Operating Expenses</b>		1,801,966	1,863,591	1,859,861	1,880,046	1,936,447
<b>Net Operating Income</b>		576,819	587,457	663,669	718,140	738,634
<b>NOI Margin</b>		24.2%	24.0%	26.3%	27.6%	27.6%
<b>Community Benchmarks</b>						
Licensed Beds		64	64	64	64	64
Average Daily Census		60.4	61.2	62.2	60.1	62.8
<b>Monthly Revenue/Licensed Bed</b>	\$	3,097.38	3,191.47	3,285.85	3,383.05	3,483.18
Occupancy %		94.4%	95.6%	97.2%	93.9%	98.1%
Annual Resident Days		22,046	22,338	22,703	21,937	22,922
<b>Expenses/Resident Day</b>	\$	81.74	83.43	81.92	85.70	84.48

- Example: 64 Unit AL/PC Community
- 5 Year Performance History
- Key Metrics: NOI, Expenses/Resident Day, Revenue/Licensed Bed
- Evaluate Performance Today and Over Time

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## II. How Valuable is a Community

- A Financial Report Card can also be used to determine the Market Value of a Community
- In Seniors Housing, Market Value is primarily based on “cash flow” (NOI)
- 3<sup>rd</sup> Party Appraisals are used by Banks, Investors, and Operators to value Communities
- Appraisals are key to attracting **capital (\$)**
- Appraisers focus on 3 areas to determine value: Comparable Sales, Replacement Cost, and **Capitalized Cash Flow (NOI)**

## NOI and Capitalization Rates Drive Value

- **Capitalization Rate:** A Factor that is derived by Market Conditions and is expressed as a percentage (%)
- Appraisers use a limited forecast period to value Communities, but how do they account for cash flow past the final projected year?
- $\text{NOI in Target Year} / \text{Capitalization Rate} = \text{Value } (\$)$
- Capitalization Rates Typically ~ 8% for ALFs and ~12% for SNFs, but depends on each unique market

## Calculate Your Community's Value Using Your Financial Scorecard

- Application: Taking Data from the Financial Scorecard and Translating it into an Expected Appraised Value
- Revenues – Operating Expenses = Net Operating Income (Cash Flow)
- Capitalization Rate – Determined by Market Conditions (locally and nationally)

	Year					
	2015	2016	2017	2018	2019	
<b>Effective Gross Revenue</b>	\$ -	2,378,786	2,451,048	2,523,530	2,598,186	2,675,081
<b>Total Operating Expenses</b>	1,801,966	1,863,591	1,859,861	1,880,046	1,936,447	
<b>Net Operating Income</b>	576,819	587,457	663,669	718,140	738,634	
<b>NOI Margin</b>	24.2%	24.0%	26.3%	27.6%	27.6%	
<b>Community Benchmarks</b>						
Licensed Beds	64	64	64	64	64	
Average Daily Census	60.4	61.2	62.2	60.1	62.8	
<b>Monthly Revenue/Licensed Bed</b>	\$ 3,097.38	\$ 3,191.47	\$ 3,285.85	\$ 3,383.05	\$ 3,483.18	
Occupancy %	94.4%	95.6%	97.2%	93.9%	98.1%	
Annual Resident Days	22,046	22,338	22,703	21,937	22,922	
<b>Expenses/Resident Day</b>	\$ 81.74	\$ 83.43	\$ 81.92	\$ 85.70	\$ 84.48	
<b>Community Valuation</b>						
Assumed Capitalization Rate	8.00%	8.25%	8.00%	8.50%	8.50%	
<b>Net Operating Income</b>	\$ 576,819	\$ 587,457	\$ 663,669	\$ 718,140	\$ 738,634	
<b>Appraised Value</b>	\$ 7,210,238	\$ 7,120,690	\$ 8,295,862	\$ 8,448,707	\$ 8,689,816	

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## III. How A+ Management Creates Value

### Case Study

- Real AL/PC Community in the Middle Atlantic
- Goal: Use the Financial Scorecard to determine the appraised value of the subject community

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## Subject Community Scorecard

		Year		
		2016	2017	2018
<b>Effective Gross Revenue</b>	\$ -	2,721,545	2,553,897	2,806,850
<b>Total Operating Expenses</b>		2,773,483	2,410,849	2,083,201
<b>Net Operating Income</b>		(51,938)	143,048	723,649
<b>NOI Margin</b>		-1.9%	5.6%	25.8%
<b>Community Benchmarks</b>				
Licensed Beds		64	64	64
Average Daily Census		53.6	51.2	51.5
<b>Monthly Revenue/Licensed Bed</b>	\$	<b>3,543.68</b>	\$ <b>3,325.39</b>	\$ <b>3,654.75</b>
Occupancy %		83.8%	80.0%	80.5%
Annual Resident Days		19,564	18,688	18,798
<b>Expenses/Resident Day</b>	\$	<b>141.76</b>	\$ <b>129.01</b>	\$ <b>110.82</b>
<b>Community Valuation</b>				
Assumed Capitalization Rate		8.00%	8.00%	8.00%

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## Case Study Conclusions

### RESULTS:

		Year		
		2016	2017	2018
<b>Effective Gross Revenue</b>	\$ -	2,721,545	2,553,897	2,806,850
<b>Total Operating Expenses</b>		2,773,483	2,410,849	2,083,201
<b>Net Operating Income</b>		(51,938)	143,048	723,649
<b>Appraised Value</b>	\$	<b>(649,222)</b>	\$ <b>1,788,096</b>	\$ <b>9,045,608</b>

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## IV. Factors that Affect Value

- Revenues
  - Balance between rates and occupancy
  - Your Rates vs. Competitors in your Market
  - Evaluating how the needs of residents change over time
- Operating Expenses
  - Staff recruiting and the use of agency services
  - Bulk purchasing of food and supplies
- Cap Rates
  - Appraisal – Directly correlated to capital availability
  - Physical Plant condition and improvements

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## Generate Revenue Growth by Reevaluating Your Market Position

- Managerial Factors:
  - Can Census be improved? Can we avoid expensive referral services?
  - Are we charging market rates +/- (in comparison to my neighboring care communities)
  - Do we offer something unique to Seniors in our area? (quality of care, facilities, activities etc.)
- Care and Community Factors:
  - Are we appropriately evaluating the care needs of each resident
  - Care needs change over time
  - Could we offer additional services to residents that would improve their health and well being?

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## Improving Efficiency Reduces Operating Expenses

- Biggest challenge facing Seniors Housing?
  - Staffing
- How can we offer premium care for residents and remain operationally efficient?
  - Employee Recruiting and Retention Strategies
  - Reducing dependency on Agency staff
  - Incentive Based Pay and Benefits
  - Using Technology to Address Call Outs
- Partner with other Communities or State Organizations to take advantage of bulk purchasing
  - Food
  - Medical Supplies / Pharmacy

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## Cap Rates and Appraisal Values Attract Capital

- Industry Cap Rates available on-line at the National Investment Center web site: [www.nic.org](http://www.nic.org)
- 2014-2016: Cap rates remained historically low, which means that appraised values were historically high nationally
- 2019: ALF (7.25% to 9.5%) SNF (10% to 12%)
- A Facility's cash flow is key.
- Value Impact:
  - Annual NOI = \$500,000
  - ALF Cap Rate = 8.5%
  - \$500,000 divided by .085 = \$5,882,350 Appraised Value**
  
  - Annual NOI = \$500,000
  - ALF Cap Rate = 7.0%
  - \$500,000 divided by .07 = \$7,142,857 Appraised Value**

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## Financing Tips: Determine Your Target Capital Request

- Go to the source with your established (reasonable) capital request, but how is that amount determined?
- Cash flow capacity to service the requested loan (Loan Coverage Covenants)
- Prepare your own preliminary (Borrower's) Valuation of the Facility.
- **Review: Appraisal 101**
  - See: Operating Financial Statements (Financial Scorecard)
    - Identify Annual Cash Flow (Revenue less Operating Expenses)
    - Removal of extraneous expenses (HQ expense, travel, personal expenses)
    - Identify Net Operating (annual) Income (NOI)
    - NOI divided by "current" Cap Rate (best determined by recent comparable sales) = Appraised Value

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## Appraisal Values are Critical

- **Key Aspect to Financial Feasibility:** Will this appraised value generate enough interest from capital providers to get the project completed?
- **Wider** the gap between Project cost and capital raised means more of the Borrower's own money must be used to complete the Project.
  - Alternative: Raise Equity or Find Mezzanine Financing
  - Some Lenders will not approve Mezzanine Debt

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## Issues with Current Appraisal Values

- Middle income senior housing projects across the country are struggling with current appraisal methodology which normalizes NOI margins to 27%
- Example:
  - Provider ABC's 2018 Budget:
    - Revenue: \$2,270,109
    - Operating Expenses: \$1,542,359
    - Projected NOI: \$727,750
    - Anticipated Value at 7.75% Cap: \$9,390,322
    - Expected Loan Proceeds at 80%: \$7,512,258
  - Actual Appraiser Conclusions
    - Revenue: \$2,328,953
    - Operating Expenses: \$1,711,334
    - Projected NOI: \$617,619
    - Anticipated Value at 7.75% Cap: \$7,969,277
    - Expected Loan Proceeds at 80%: \$6,375,421
    - **Loan Proceeds Lost: \$1,136,837**

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## V. Conclusions

- Why does Value Matter in Seniors Housing?
  - + NOI = + Appraised Value
  - Improved Appraised Value open doors to new (and cheaper) Capital Sources
  - Risk vs. Reward for Investors
- Capital provides opportunity for residents and staff
  - Create a better place to work and live through investment in the community
  - Improve the quality of life for residents with investments in technology
  - Reduce stress on caregivers by investing in documentation software and medication management equipment
  - Attract and retain the best staff (\$ and benefits)
  - Allow operators / management companies to expand their footprint
    - Offer advancement opportunities
    - Provide higher quality care for more seniors

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# V. Questions and Answers

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